

UNITED STATES DEPARTMENT OF AGRICULTURE

Farm Service Agency
Washington, DC 20250

Notice LP-2045

For: State and County Offices, CMA's, DMA's, and LSA's

National County Operations Review Program (CORP) Review for Improper Payments

Approved by: Deputy Administrator, Farm Programs



1 Improper Payments Review

A Background

The Improper Payments Information Act (IPIA) of 2002 requires Federal agencies to evaluate programs to determine if internal controls are sufficient to prevent improper payments. The CORP review of 2005 program year for marketing assistance loans (MAL's), LDP's, and 2004 program year DCP was completed to examine the risk of improper or erroneous payments in these 3 farm program areas.

Note: Reviews have also been completed for CRP, NAP, and the Crop Disaster Assistance Program (CDP) and will be addressed in future notices.

These reviews will enable FSA to have reliable and statistical data to discern the overall effectiveness of programs and determine management controls needed to conform to IPIA requirements.

OMB defines an improper payment as any payment that should **not** have been made or was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement. Incorrect amounts are overpayments and underpayments. A nationwide statistical sample is being used for all national CORP reviews. The number of errors found in MAL, LDP, and DCP administration had a significant impact in adhering to internal controls and procedures to reasonably ensure that payments and disbursements are valid and sufficiently supported to prevent improper payments.

OMB Circular A-123, Appendix A emphasizes management's focus on ensuring effective internal control over financial reporting and to strengthen the process management use to assess internal control over financial reporting effective FY 2006. PricewaterhouseCoopers has also identified internal control weaknesses for which OMB requires that a corrective action plan (CAP) be developed for any control deemed to be ineffective or missing.

Disposal Date	Distribution
February 1, 2007	State Offices; State Offices relay to County Offices and FAX to CMA's, DMA's, and LSA's

1 Improper Payments Review (Continued)

A Background (Continued)

DAFP and DAFO chartered a task force consisting of SED's, DD's, CED's, program technicians, and State Office program specialists to recommend actions for reducing improper program payments and for improving farm program delivery throughout County Offices nationwide. The task force met in August and will meet again in October to pinpoint areas of needed training and methods to improve farm program delivery.

B Purpose

This notice provides State and County Offices the following:

- details of findings discovered during the CORP review of MAL, LDP, and DCP
- established policy and procedure references for each finding
- IPIA of 2002 (Exhibit 1)
- implementation guidance for IPIA of 2002, P.L. 107-300 (Exhibit 2).

C Action

SED's shall:

- ensure that applicable State Office division chiefs and specialists review this notice in detail to develop CAP, as needed, to ensure that County Offices follow applicable program procedures issued through National Notices and program handbooks
- establish additional internal control procedures to avoid findings indicated by CORP reviews
- ensure that applicable State Office program divisions provide additional program training where needed and implement a CAP to reduce improper payments
- ensure that DD's hold a meeting within their respective districts to review this notice with CED's and program technicians.

Note: A PowerPoint presentation pertaining to the findings and necessary internal controls will be provided by the National Office to assist in this process.

2 Price Support CORP Findings for Program Year 2005

A MAL and LDP Eligibility

Finding: Producer did **not** certify whether or not they had a delinquent Federal non-tax debt.

Policy: 8-LP, paragraph 101 instructs County Office to have producers certify that they do not have a delinquent Federal non-tax debt. Also, 8-LP, Exhibit 8 provides DCIA questions and answers and 58-FI provides additional DCIA policy.

MAL's in sample with error	205
Sample error rate	21.20%
Estimated number of MAL's with error	34,605
LDP's in sample with error	16
Sample error rate	1.58%
Estimated number of LDP's with error	Error rate too low to estimate value.

Finding: Producer did **not** have beneficial interest in the commodity at the time the loan or LDP was made.

Policy: 8-LP, paragraph 129 provides MAL and LDP beneficial interest policy. A producer is considered ineligible for a MAL or LDP if the producer does not have beneficial interest in the commodity at the time of MAL or LDP request.

MAL's in sample with error	0
Sample error rate	0
Estimated number of MAL's with error	0
LDP's in sample with error	4
Sample error rate	0.40%
Estimated number of LDP's with error	Error rate too low to estimate value.

2 Price Support CORP Findings for Program Year 2005 (Continued)

A MAL and LDP Eligibility (Continued)

Finding: Producer did **not** share in the risk of producing the commodity pledged for loan or for which the LDP was requested.

Policy: 8-LP, subparagraph 100 A states that an eligible producer is a person or entity that shares in the risk of producing the applicable commodity.

MAL's in sample with error	2
Sample error rate	0.21%
Estimated number of MAL's with error	Error rate too low to estimate value.
LDP's in sample with error	4
Sample error rate	0.40%
Estimated number of LDP's with error	Error rate too low to estimate value.

Finding: LDP was made to a producer **without** a properly completed CCC-526 or other acceptable certification on file. This would include CCC-526's not signed or signed by an unauthorized representative.

Policy: 8-LP, paragraph 105 A provides adjusted gross income (AGI) policy. Also, 1-PL provides additional AGI policy.

LDP's in sample with error	43
Sample error rate	4.26%
Estimated number of LDP's with error	33,729

B MAL's

Finding: Lien search was **not** performed before the loan was made or the search was performed before the loan was requested.

Policy: 8-LP, subparagraph 403 B instructs County Offices to:

- perform a lien search after a loan request is filed and before the loan is approved
- **not** perform a lien search before a loan request is filed.

Note: Follow Notice LP-2027 for 2006 and subsequent crop years.

MAL's in sample with error	143
Sample error rate	17.31%
Estimated number of LDP's with error	21,228

2 Price Support CORP Findings for Program Year 2005 (Continued)

B MAL's (Continued)

Finding: Required lien waivers were **not** obtained before loan was made.

Policy: 8-LP, subparagraph 404 A states that a lien waiver shall be obtained before disbursing a MAL.

MAL's in sample with error	29
Sample error rate	3.51%
Estimated number of MAL's with error	4,849

Finding: When required, financing statement was **not** filed before the loan was made.

Policy: 8-LP, paragraph 414 provides policy and procedures for obtaining CCC-10's. CCC-10's serve as CCC's or FSA's notice of intent to perfect security interest in the commodity.

MAL's in sample with error	7
Sample error rate	1.10%
Estimated number of MAL's with error	Error rate too low to estimate value.

C Combination MAL and LDP

Finding: Loan note or LDP application was **not** signed by the person with authority to sign on their behalf. This would include loans made to CMA's and DMA's where the note or LDP application was signed by someone other than an authorized representative of the CMA or DMA.

Policy: 8-LP, subparagraph 3 A provides policy for signatures, authorizations, and approvals. Also refer to 1-CM. By completing and signing the loan note or LDP request, the producer enters into an agreement with CCC.

MAL's in sample with error	58
Sample error rate	10.14%
Estimated number of MAL's with error	9,456
LDP's in sample with error	82
Sample error rate	18.43%
Estimated number of LDP's with error	100,605

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2 Price Support CORP Findings for Program Year 2005 (Continued)

C Combination MAL and LDP (Continued)

Finding: There is no LDP application (CCC-709 PELT, CCC-633 PELT, CCC-633 EZ) or CCC-666 on file for the loan or LDP made. This would include LDP applications or loan requests not signed or signed by an unauthorized representative or an applicable or loan request that is not completed with enough information to support the loan or LDP made.

Policy: 8-LP, Part 3 and National Notices LP-2014, 2017, 2021, and 2024 provide policy and procedures for obtaining LDP's. It is important that a producer complete the prescribed LDP request form. By completing and signing the LDP request, the producer enters into an agreement with CCC.

MAL's in sample with error	20
Sample error rate	2.07%
Estimated number of MAL's with error	2,628
LDP's in sample with error	10
Sample error rate	0.99%
Estimated number of LDP's with error	Error rate too low to estimate value.

Finding: Loan or LDP was made when the quantity exceeded the COC-established yield without the COC determining the quantity was reasonable.

Policy: 8-LP, subparagraph 132 provides the policy for eligible quantity. If the eligible quantity exceeds the COC-established yield, the COC must determine the requested quantity is reasonable.

MAL's in sample with error	10
Sample error rate	1.03%
Estimated number of MAL's with error	1,100
LDP's in sample with error	18
Sample error rate	1.78%
Estimated number of LDP's with error	18,363

2 Price Support CORP Findings for Program Year 2005 (Continued)

C Combination MAL and LDP (Continued)

Finding: Loan exceeded \$150,000 or LDP exceeded \$100,000 and the producer did **not** provide the applicable CCC-674 or SF-LLL. This would include documents not signed or signed by an unauthorized representative.

Policy: 8-LP, paragraph 17 requires County Offices to obtain CCC-674 or SF-LLL when a loan exceeds \$150,000 or LDP exceeds \$100,000.

MAL's in sample with error	17
Sample error rate	10.63%
Estimated number of MAL's with error	657
LDP's in sample with error	2
Sample error rate	9.09%
Estimated number of LDP's with error	Error rate too low to estimate value.

Finding: Loan or LDP quantity and rate was incorrect.

Policy: 8-LP, Part 3 provides policy and procedures for LDP's and Part 15 provides policy and procedures for MAL's. County Offices must ensure the MAL and/or LDP rate and quantity is accurate before disbursing or issuing the benefit.

MAL's in sample with error in quantity	10
Sample error rate	1.03%
Estimated number of MAL's with error	1,441
LDP's in sample with error in quantity	27
Sample error rate	2.67%
Estimated number of LDP's with error	39,406
MAL's in sample with error in rate	3
Sample error rate	0.31%
Estimated number of MAL's with error	Error rate too low to estimate value.
LDP's in sample with error in rate	9
Sample error rate	0.89%
Estimated number of LDP's with error	13,121

2 Price Support CORP Findings for Program Year 2005 (Continued)

C Combination MAL and LDP (Continued)

Finding: Second party review was **not** completed before the loan or LDP was made.

Policy: 8-LP, paragraph 136 A instructs County Offices to have a 2nd party review of eligibility requirements performed before disbursing a loan or LDP. The 2nd party reviewer must initial the MAL or LDP request when the review is completed.

MAL's in sample with error	640
Sample error rate	66.18%
Estimated number of MAL's with error	117,044
LDP's in sample with error	273
Sample error rate	41.74%
Estimated number of LDP's with error	348,687

Finding: Loan or LDP was **not** approved by an authorized CCC representative. This would include a missing signature.

Policy: 8-LP, subparagraph 3 B provides the policy for redelegation of authority for COC's or CED's. All MAL and LDP requests must be approved by an authorized CCC representative before MAL is disbursed or LDP is issued.

MAL's in sample with error	62
Sample error rate	6.41%
Estimated number of MAL's with error	10,887
LDP's in sample with error	111
Sample error rate	11.14%
Estimated number of LDP's with error	145,486

3 DCP

A DCP Findings

Finding: Signature on CCC-509 was missing.

Policy: 1-DCP, Part 6, Section 4 provides the signatures that must be present before CCC-509 can be approved.

CCC-509's in sample with error	207
Sample error rate	6.2%
Estimated number of CCC-509's in error	122,386

Finding: Proper "cash rent tenant" determinations were **not** made. This included findings that the documentation did not support the determination and cases where there was no documentation.

Policy: 2-DCP, paragraph 12 requires that cash rent tenant determinations must be made according to 1-PL as a prerequisite for making payments.

CCC-509's in sample with error	59
Sample error rate	2.9%
Estimated number of CCC-509's in error	290,245

Finding: There was no AGI certification or the documentation in the office did not support the AGI determination made.

Policy: 2-DCP, paragraph 12 requires that AGI determinations must be made according to 1-PL as a prerequisite for making payments.

CCC-509's in sample with error	51
Sample error rate	3.0%
Estimated number of CCC-509's in error	210,254

Finding: CCC-509 was signed after June 1, but the fee for filing late was not assessed.

Policy: The final date to enter into CCC-509 is June 1. A late filed contracted can be approved **only** if the late fee is assessed according to 1-DCP, paragraph 331.

CCC-509's in sample with error	9
Sample error rate	Error rate too low to estimate value.
Estimated number of CCC-509's in error	Error rate too low to estimate value.

4 Findings Applicable to MAL's, LDP's, and DCP

A Program and Payment Eligibility

The findings in this paragraph relate to requirements that are applicable to numerous farm programs. Therefore, the finding in 1 program means that the same finding is applicable to all programs that have the common requirement. The result is that all the applicable programs have improper payments.

Finding: Signatures were accepted on documents, applications, and contracts from an individual acting in a representative authority; however, there was no documentation in the office, documentation was incomplete, or the documentation was misinterpreted.

Policy: Signatures can be accepted from representatives only if 1-CM provisions are met.

CCC-509's in sample with error	127
Sample error rate	4.5%
Estimated number of CCC-509's in error	239,938
MAL's in sample with error	58
Sample error rate	10.14%
Estimated number of MAL's in error	9,456
LDP's in sample with error	82
Sample error rate	18.43%
Estimated number of LDP's in error	100,605

Finding: Producer did **not** file FSA-578 on all cropland on the farm for which the payment was requested. For FSA-578 to be considered filed, the acreage had to be reported using OMB approved FSA-578 and have been reported by applicable producers or their authorized representative.

Policy: 8-LP, paragraph 101 provides that producers who have not reported acreage on FSA-578 according to 2-CP for the current crop year are ineligible for a MAL or LDP. 1-DCP, subparagraph 11 B and 2-DCP, paragraph 12 and Exhibit 7 require that FSA-578 must be filed according to 2-CP as a payment eligibility criteria for receiving final DCP payments.

CCC-509's in sample with error	23
Sample error rate	2.1%
Estimated number of CCC-509's in error	135,396
MAL's in sample with error	14
Sample error rate	1.44%
Estimated number of MAL's in error	Error rate too low to estimate value.
LDP's in sample with error	2
Sample error rate	0.20%
Estimated number of LDP's in error	Error rate too low to estimate value.

4 Findings Applicable to MAL's, LDP's, and DCP (Continued)

A Program and Payment Eligibility (Continued)

Finding: Producer did **not** have an AD-1026 on file that covered the applicable crop. For AD-1026 to be considered filed, it must be applicable to all farmland the producer was farming in the applicable year and be signed by the applicable producer or their authorized representative.

Policy: 8-LP, paragraph 100 provides that a producer must have filed an AD-1026 according to 6-CP in the applicable County Office before the producer can be considered eligible for a MAL or LDP. 2-DCP, paragraph 12 and Exhibit 7 require that AD-1026 must be filed according to 6-CP as a payment eligibility criteria for receiving final DCP payments.

CCC-509's in sample with error	145
Sample error rate	5.7
Estimated number of CCC-509's in error	82,595
MAL's in sample with error	22
Sample error rate	2.28%
Estimated number of MAL's in error	4,130
LDP's in sample with error	25
Sample error rate	2.48%
Estimated number of LDP's in error	23,914

Finding: Payment was made to a producer before a properly completed CCC-502 had been filed. This would include CCC-502's not signed or signed by an unauthorized representative.

Policy: 8-LP, subparagraph 100 provides MAL and LDP producer eligibility requirements. A producer is considered ineligible for a MAL or LDP if CCC-502 is not properly filed according to 1-PL. 2-DCP, paragraph 12 provides that determinations must be made according to 1-PL as payment eligibility criteria for receiving DCP payments. 1-PL provides requirements for completing CCC-502's and 1-CM provides authorities for someone signing in a representative authority.

CCC-509's in sample error	20
Sample error rate	1.10%
Estimated number of CCC-509's in error	122,152
LDP's in sample with error	45
Sample error rate	4.46%
Estimated number of LDP's in error	64,620

4 Findings Applicable to MAL's, LDP's, and DCP (Continued)

A Program and Payment Eligibility (Continued)

Finding: Payments were made to a producer before a “person” and/or “actively engaged in farming” determination was made.

Policy: 8-LP, subparagraph 100 provides MAL and LDP producer eligibility requirements. A producer is considered ineligible for a MAL and LDP if a CCC-502 is not properly filed according to 1-PL. 2-DCP, paragraph 12 and Exhibit 7 require that “person” and “actively engaged in farming” determinations must be made according to 1-PL as a prerequisite for issuing DCP payments.

CCC-509's in sample with error	18
Sample error rate	1.0%
Estimated number of CCC-509's in error	150,154
LDP's in sample with error	33
Sample error rate	3.27%
Estimated number of LDP's in error	41,241

Improper Payments Information Act of 2002

116 STAT. 2350

PUBLIC LAW 107-300—NOV. 26, 2002

Public Law 107-300
107th Congress

An Act

Nov. 26, 2002
[H.R. 4878]

To provide for estimates and reports of improper payments by Federal agencies.

*Be it enacted by the Senate and House of Representatives of
the United States of America in Congress assembled,*Improper
Payments
Information Act
of 2002.
31 USC 3321
note.**SECTION 1. SHORT TITLE.**This Act may be cited as the "Improper Payments Information
Act of 2002".31 USC 3321
note.**SEC. 2. ESTIMATES OF IMPROPER PAYMENTS AND REPORTS ON
ACTIONS TO REDUCE THEM.**(a) **IDENTIFICATION OF SUSCEPTIBLE PROGRAMS AND ACTIVITIES.**—The head of each agency shall, in accordance with guidance prescribed by the Director of the Office of Management and Budget, annually review all programs and activities that it administers and identify all such programs and activities that may be susceptible to significant improper payments.(b) **ESTIMATION OF IMPROPER PAYMENT.**—With respect to each program and activity identified under subsection (a), the head of the agency concerned shall—(1) estimate the annual amount of improper payments;
and

Deadline.

(2) submit those estimates to Congress before March 31 of the following applicable year, with all agencies using the same method of reporting, as determined by the Director of the Office of Management and Budget.

(c) **REPORTS ON ACTIONS TO REDUCE IMPROPER PAYMENTS.**—With respect to any program or activity of an agency with estimated improper payments under subsection (b) that exceed \$10,000,000, the head of the agency shall provide with the estimate under subsection (b) a report on what actions the agency is taking to reduce the improper payments, including—

(1) a discussion of the causes of the improper payments identified, actions taken to correct those causes, and results of the actions taken to address those causes;

(2) a statement of whether the agency has the information systems and other infrastructure it needs in order to reduce improper payments to minimal cost-effective levels;

(3) if the agency does not have such systems and infrastructure, a description of the resources the agency has requested in its budget submission to obtain the necessary information systems and infrastructure; and

(4) a description of the steps the agency has taken to ensure that agency managers (including the agency head) are held accountable for reducing improper payments.

Improper Payments Information Act of 2002 (Continued)

PUBLIC LAW 107-300—NOV. 26, 2002

116 STAT. 2351

(d) DEFINITIONS.—For the purposes of this section:

(1) AGENCY.—The term “agency” means an executive agency, as that term is defined in section 102 of title 31, United States Code.

(2) IMPROPER PAYMENT.—The term “improper payment”—

(A) means any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; and

(B) includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts.

(3) PAYMENT.—The term “payment” means any payment (including a commitment for future payment, such as a loan guarantee) that is—

(A) made by a Federal agency, a Federal contractor, or a governmental or other organization administering a Federal program or activity; and

(B) derived from Federal funds or other Federal resources or that will be reimbursed from Federal funds or other Federal resources.

(e) APPLICATION.—This section—

(1) applies with respect to the administration of programs, and improper payments under programs, in fiscal years after fiscal year 2002; and

(2) requires the inclusion of estimates under subsection (b)(2) only in annual budget submissions for fiscal years after fiscal year 2003.

(f) GUIDANCE BY THE OFFICE OF MANAGEMENT AND BUDGET.—Deadline.
Not later than 6 months after the date of enactment of this Act, the Director of the Office of Management and Budget shall prescribe guidance to implement the requirements of this section.

Approved November 26, 2002.

LEGISLATIVE HISTORY—H.R. 4878:

SENATE REPORTS: No. 107-333 (Comm. on Governmental Affairs).
CONGRESSIONAL RECORD, Vol. 148 (2002):

July 9, considered and passed House.

Oct. 17, considered and passed Senate, amended.

Nov. 12, House concurred in Senate amendment.

Implementation Guidance for the Improper Payments Information Act of 2002, P.L. 107-300**Implementation Guidance for the Improper Payments
Information Act of 2002, P.L. 107-300****Introduction**

A component of the President's Management Agenda is the initiative to reduce erroneous payments. Agencies with programs listed in Section 57 of the OMB Circular A-11 are required to report annually on the extent of the erroneous payments in those programs and the actions they are taking to reduce erroneous payments. The Improper Payments Information Act of 2002 (Act) (Public Law 107-300) has extended the erroneous payment reporting requirements to programs and activities beyond those listed in Circular A-11. This guidance implements the requirements of the Act and supercedes Section 57 of Circular A-11. (See below.)

What is an erroneous or improper payment? (The term "erroneous payment" and "improper payment" have the same meaning in this document.)

An erroneous payment is any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirement. Incorrect amounts are overpayments and under payments (including inappropriate denials of payment or service). An erroneous payment includes any payment that was made to an ineligible recipient or for an ineligible service. Erroneous payments are also duplicate payments, payments for services not received, and payments that do not account for credit for applicable discounts.

The term "payment" means any payment derived from Federal funds or other Federal sources or that will be reimbursed from Federal funds or other Federal resources (including a commitment for future payment, such as a loan guarantee) that is made by a Federal agency, a Federal contractor, or a governmental or other organization administering a Federal program or activity. This includes Federal awards subject to the Single Audit Act Amendments of 1996 (Single Audit Act) which are expended by both recipients and subrecipients as well as Federal grants and subgrants to for-profit and non-U.S. based entities not subject to the Single Audit Act.

What agencies are required to comply with the requirements of the Improper Payments Information Act of 2002 (Public Law No: 107-300)?

The Act defines agency broadly as "a department, agency, or instrumentality in the executive branch of the United States."

How is the term "program and activity" defined? (The term "program and activity" is referred to in this document as "program.")

The Act anticipates that agencies will examine the risk of erroneous payments in all programs and activities they administer, well beyond just those listed in Section 57 of OMB Circular A-11. The term program includes activities or sets of activities recognized as programs by the public,

**Implementation Guidance for the Improper Payments Information Act of 2002, P.L. 107-300
(Continued)**

OMB, or Congress as well as those that entail program management or policy direction. This definition includes, but is not limited to, all grants including competitive grant programs and block/formula grant programs, regulatory activities, research and development activities, direct Federal programs, all procurements including capital assets and service acquisition, and credit programs. It also includes the activities engaged in by the agency in support of its programs.

For Federal awards subject to the Single Audit Act or otherwise listed in the Catalog of Federal Domestic Assistance (CFDA), Federal agencies should consider using the groupings in the OMB Circular A-133 Compliance Supplement and the CFDA. However, unless specifically specified in OMB Circular A-11, each Federal agency, after consultation with OMB, is authorized to determine the grouping of programs which most clearly identifies and reports erroneous payments for their agency.

What are agencies required to do?

Agencies are required to review annually all programs and activities they administer and identify those which may be susceptible to significant erroneous payments. This includes payments from Federal awards made by recipients and subrecipients subject to the Single Audit Act Amendments of 1996 as well as Federal grants and subgrants expended by for-profit and non-U.S. based entities not subject to that Act. For all programs and activities where the risk of erroneous payments is significant, agencies shall estimate the annual amount of erroneous payments, and report the estimates to the President and Congress with a progress report on actions to reduce erroneous payments.

Step 1: Review all programs and activities and identify those which are susceptible to significant erroneous payments.

Many agencies already know which programs and activities are at the highest risk of erroneous payments. Agencies shall institute a systematic method of reviewing all programs and identifying those it believes are susceptible to significant erroneous payments. For the purposes of this guidance, significant erroneous payments are defined as annual erroneous payments in the program exceeding both 2.5 % of program payments and \$10 million. The agency shall maintain documentation to support this review and the results.

To clarify this step, we provide three examples:

Example 1. Under the analysis in step 1, a program has a potential error rate of 2.25% or \$14 million. Under this guidance, an agency need not perform step 2, making a statistically valid estimate of erroneous payments in the program, because the potential error rate does not exceed 2.5%. In addition, the agency need not report an error rate for the program in its annual Performance and Accountability Report.

Implementation Guidance for the Improper Payments Information Act of 2002, P.L. 107-300 (Continued)

Example 2. Under the analysis in step 1, a program has a potential error rate of 2.75% or \$9 million. Under this guidance, an agency need not perform step 2, making a statistically valid estimate of erroneous payments in the program, because the potential amount of erroneous payments in the program does not exceed \$10 million. In addition, the agency need not report an error rate for the program in its annual Performance and Accountability Report.

Example 3. Under the analysis in step 1, a program has a potential error rate of 2.75% or \$11 million. Under this guidance, an agency must perform step 2, making a statistically valid estimate of erroneous payments in the program, because the potential error rate exceeds 2.5% and the potential amount of erroneous payments exceeds \$10 million. The agency must report a statistically valid error rate for the program in its annual Performance and Accountability Report.

Step 2: Statistically Valid Estimate of the annual amount of erroneous payments in programs and activities

For all programs and activities susceptible to significant erroneous payments, agencies shall determine an annual estimated amount of erroneous payments made in those programs and activities. This estimate is a gross total of both over and under payments (i.e., not the net of over and under payments). Agencies should consult with a statistician in drawing their samples and in calculating the necessary sample size. The estimates shall be based on the equivalent of a statistical random sample with a precision requiring a sample of sufficient size to yield an estimate with a 90% confidence interval of plus or minus 2.5% around the estimate of the percentage of erroneous payments. And because the margin of error of a percentage estimate is related to the size of that estimate, the agency may use their initial determination of the *potential* error in step 1 to determine their sample size.¹

To clarify this step, we provide two examples:

Example 1: Under the analysis in step 1, the program has a potential error rate of

¹ The minimum sample size needed to meet the precision requirements can be approximated by the following formula, which is used in the examples:

$$n \geq \frac{2.706(1-P)}{\left(\frac{.025}{P}\right)^2}$$

where

n is the required minimum sample size

P is the estimated percentage of erroneous payments

(Note: This sample size formula is derived from *Sampling of Populations: Methods and Applications* (3rd edition); Levy, P. S. & Lemeshow, S. (1999); New York: John Wiley & Sons; at page 74.)

**Implementation Guidance for the Improper Payments Information Act of 2002, P.L. 107-300
(Continued)**

3 % (and at least \$10 million). Under this guidance the agency needs to draw a random sample of cases from the program that will yield a statistical estimate of the erroneous payment rate. The 90 % confidence interval around this estimate should be no more than plus or minus 2.5%. Using the initial determination of 3% yields a minimum sample size of approximately 126 cases.

Example 2: Under the analysis in step 1, the program has a potential error rate of 4.5 % (and at least \$10 million). The required minimum sample size to achieve a 90 % confidence interval around this estimate of 4.5% of plus or minus 2.5% is approximately 186 cases.

Because of the imprecision of the risk assessment performed in step 1, agencies should ensure that they do not select too small of a sample. Because the size of the error rate is related to its margin of error, agencies should be conservative and use a higher estimated error rate in their sample size calculations to ensure they will meet the precision targets. Furthermore, these guidelines for precision should be taken as the minimum, and agencies are encouraged to increase samples above the minimum to achieve greater precision in their estimates. The agency shall maintain documentation to support the calculation of these estimates. Agencies should consider working with entities subject to A-133 audits to use ongoing audits to assist in the process to estimate an erroneous payment rate.

Step 3: Implement a Plan to reduce erroneous payments

For all programs and activities as determined under Step 2 with erroneous payments exceeding \$10 million, agencies shall identify the precise reasons its programs and activities are at risk of erroneous payments and put in place a plan to reduce them. To determine the precise reasons for erroneous payments, agencies may be required to conduct an analysis of erroneous payments that produces an error rate at higher levels of confidence and precision than that prescribed by this guidance.

When compiling its plan to reduce erroneous payments, agencies shall set targets for future erroneous payment levels and a timeline by which the targets will be reached. In addition, agencies must ensure that agency managers (including the agency head) are held accountable for reducing erroneous payments. Agencies shall assess whether they have the information systems and other infrastructure needed to reduce erroneous payments to minimal cost-effective levels and identify any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing erroneous payments.

Step 4: Report estimates of the annual amount of erroneous payments in programs and activities and progress in reducing them

**Implementation Guidance for the Improper Payments Information Act of 2002, P.L. 107-300
(Continued)**

Agencies shall report to the President and Congress an estimate of the annual amount of erroneous payments for all programs and activities as determined under Step 2 with erroneous payments exceeding \$10 million. As described in Step 2, the estimates shall be based on the equivalent of a statistical sample with 90% confidence and 5% precision and the reporting shall be the gross amount of both over and under payments. Agencies shall include the following in their reports to the President and Congress:

- The estimate of the annual amount of erroneous payments (gross over and under payments) made in the program and the methodology used to arrive at that estimate.
- A discussion of the causes of the erroneous payments identified, actions taken to correct those causes, and results of the actions taken to address those causes.
- A discussion of the amount of actual erroneous payments the agency expects to recover and how it will go about recovering them.
- A statement of whether the agency has the information systems and other infrastructure it needs in order to reduce erroneous payments to the levels the agency has targeted.
- If the agency does not have such systems and infrastructure, a description of the resources the agency has requested in its most recent budget submission to Congress to obtain the necessary information systems and infrastructure.
- A description of the steps (including time line) the agency has taken and plans to take to ensure that agency managers (including the agency head) are held accountable for reducing and recovering erroneous payments.
- A description of any statutory or regulatory barriers which may limit the agencies' corrective actions in reducing erroneous payments.
- Provided the agency has estimated a baseline erroneous payment rate for the program, a target for the program's future erroneous payment rate that is lower than the agency's most recent estimated error rate.

Where and when should agencies report the information required by the Act?

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Agencies shall include the reporting requirements of this guidance in the Management Discussion and Analysis section of their Performance and Accountability Report for fiscal years ending on or after September 30, 2004. The annual estimate of erroneous payments reported in the Performance and Accountability Report can be based on data from a year other than the fiscal year the Performance and Accountability Report covers. Progress under the requirements of Section 57 of OMB Circular A-11 shall be reported in the FY 2003 Performance and Accountability Reports.

What constitutes an erroneous loan or loan guarantee payment?**Direct loans:**

Under a direct loan program, erroneous payments may include loan disbursements based on incomplete, inaccurate, or fraudulent information. These may also include duplicate disbursements or other permitted third-party payments, disbursements in the incorrect amount, or loan funds used for purposes other than those allowed by law or program regulations.

Loan guarantee:

Under a loan guarantee, an erroneous payment may include disbursements to intermediaries for defaults, delinquencies, interest subsidies, other subsidies or other permitted third-party payments that are based on incomplete, inaccurate, or fraudulent information. Improper payments may also include duplicate disbursements, disbursements in the incorrect amount, or any disbursements that support loans not in compliance with law or program regulations.

When will this policy replace the current Section 57 of OMB Circular A-11.

Agencies and programs currently covered by Section 57 of OMB Circular A-11 (list attached) shall continue to estimate and reduce erroneous payments as they have been pursuant to Section 57 of A-11. Progress under the requirements of Section 57 of OMB Circular A-11 should be reported in the FY 2003 Performance and Accountability Reports. Subsequent reporting of erroneous payment remediation activities should follow this guidance, as it will supersede Section 57 of OMB Circular A-11.

How does this guidance affect recovery auditing activities?

This guidance does not affect recovery auditing activities in agencies. However, agencies may use data gathered as part of their recovery auditing activities in determining an erroneous payment rate for its procurement activities as required by this guidance.

Where can agencies go to find more information about estimating and reducing erroneous payments?

The Erroneous and Improper Payments Working Group, composed of members of the Chief Financial Officers Council and the President's Council on Integrity and Efficiency, reviewed the methods various agencies were using to assess the extent of erroneous payments they make. More information on the Erroneous and Improper Payments Work Group's analysis of agency

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erroneous payment assessment practices can be found at
<http://www.cfoc.gov/documents/EIP%20Posn.Paper%2011-02.doc>.

The General Accounting Office surveyed public and private sector organizations and issued a report on the practices they employ to measure and prevent erroneous payments. That report, General Accounting Office Report: Strategies to Manage Improper Payments: Learning from Public and Private Sector Organizations (GAO-02-69G), can be found at www.gao.gov/cgi-bin/getrpt?gao-02-69G.